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7 PACIFIC GAS AND ELECTRIC COMPANY
8

9 UNITED STATES BANKRUPTCY COURT
10 NORTHERN DISTRICT OF CALIFORNIA
11 SAN FRANCISCO DIVISION

12 In re

Case No. 01-30923 DM

13 PACIFIC GAS AND ELECTRIC
COMPANY, a California corporation,

Chapter 11 Case

14 Debtor.
15

Date: November 14, 2002
Time: 9:30 a.m.
Place: 235 Pine Street, 22nd Floor
San Francisco, California

Federal I.D. No. 94-0742640
16

17 DECLARATION OF ERIC R. SCOTT IN SUPPORT OF
18 MOTION FOR AUTHORITY TO ENTER INTO
19 CERTAIN POWER PROCUREMENT CONTRACTS
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DECLARATION OF ERIC R. SCOTT

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HOWARD
RICE
NEMEROVSKI
CANADY
FALK
& RABKIN
A Professional Corporation

1 I, Eric R. Scott, declare:

2 1. I have been employed by Pacific Gas and Electric Company ("PG&E")
3 since 1972. Since March 2001, I have held the position of Manager of Market and
4 Regulatory Issues. In this position, I am responsible for assessment of regulatory and
5 legislative issues pertaining to electric procurement and for managing specific electric
6 procurement projects.

7 2. This declaration is submitted in support of PG&E's Motion for Authority to
8 Enter into Certain Power Procurement Contracts (the "Motion"). Defined terms used herein
9 shall have the meanings set forth in the Motion. I make this declaration based on personal
10 knowledge, except where otherwise indicated, and if called as a witness, could and would
11 testify competently to the matters set forth herein.

12 3. Due to a number of events that occurred prior to the filing of PG&E's
13 Chapter 11 petition, including the downgrading of its credit ratings and resulting loss of its
14 investment-grade status, PG&E became unable to obtain wholesale power in early 2001. In
15 January 2001, DWR was authorized to purchase power to maintain the continuity of supply
16 to retail customers of PG&E and other investor owned utilities (collectively, the "IOUs"). In
17 February 2001, Assembly Bill No. 1 of the first extraordinary session ("AB 1X") was
18 enacted into law, authorizing DWR to enter into contracts for the purchase of electric power.
19 AB 1X also required PG&E to deliver the power purchased by DWR over its distribution
20 systems and act as a billing agent on behalf of DWR, but did not make PG&E legally or
21 financially responsible for DWR's contracts. AB 1X prohibited DWR from entering into
22 new contracts to purchase energy on and after January 1, 2003.

23 4. Despite the large number of power contracts already entered into by DWR,
24 there remains a net short position for PG&E in 2003 and beyond, particularly during the
25 hours of each month with the highest customer demand ("peak hours"). An agreement with
26 DWR under which DWR will enter into new power purchase contracts, subject to PG&E
27 taking responsibility for such contracts if and when it becomes investment-grade, along with
28 extending certain pre-existing QF contracts, will allow PG&E to call upon power during the

DECLARATION OF ERIC R. SCOTT

1 peak hours to reduce its reliance on the "spot market," thereby mitigating electric price and
2 volume volatilities for PG&E's net short position and thus stabilizing rates for its customers.
3 At the same time, PG&E's financial and legal risks under the contracts will be minimized,
4 because DWR will be the financially and legally responsible party under the new contracts
5 until such time as PG&E is investment-grade again, and DWR's costs will be recovered
6 directly from retail customers rather than from PG&E's estate.

7 5. The California Public Utilities Commission (the "CPUC") issued its
8 Decision 02-08-071 on August 22, 2002 in the proceedings entitled *Order Instituting*
9 *Rulemaking to Establish Policies and Cost Recovery Mechanisms for Generation*
10 *Procurement and Renewable Resource Development* (the "CPUC Decision"). The CPUC
11 Decision sets forth procedures for PG&E (and the other IOUs) to follow for an expedited
12 procurement process in order to facilitate electric procurement for the period from January 1,
13 2003 until such time as PG&E regains an investment-grade credit rating. A true and correct
14 copy of the CPUC Decision is attached hereto as Exhibit A.

15 6. The CPUC Decision acknowledges the need to minimize exposure of the
16 IOUs' customers to volatile electricity spot market prices and authorizes the IOUs, on an
17 interim basis through the end of 2002, to jointly enter into new power purchase contracts
18 with DWR (the "Interim Procurement Contracts") to meet the utilities' remaining net short
19 position. DWR would have all legal and financial responsibility for these contracts and,
20 under AB 1X, would be authorized to recover the costs of the contracts in its own rates
21 under its own statutory authority, rather than through PG&E's rates or from PG&E. Under
22 the terms of the joint contracts, at such time as PG&E regains its investment-grade credit
23 rating from both Standard and Poor's and Moody's Investors Service, PG&E would assume
24 all legal and financial responsibility for the contracts and DWR's further obligations would
25 be extinguished. Pursuant to the CPUC Decision, if the IOUs choose to enter into such
26 interim contracts, the IOUs are required to hold a competitive solicitation for the Interim
27 Procurement Contracts, to consult with a group of non-market participants (referred to as the
28 "Procurement Review Group") on the results of the solicitation and to submit proposed

1 contracts to the CPUC for expedited approval after the winning bidders are selected.

2 7. The CPUC Decision and recently-enacted legislation require the IOUs to
3 procure renewable energy to ensure that an additional one percent (1%) per year of the
4 IOUs' annual electricity sales (approximately 750 GWh for PG&E) is generated from
5 renewable resources. The CPUC Decision directs that each IOU hold a competitive
6 solicitation to procure the renewable energy required (the "Renewable Energy Contracts")
7 and to submit the proposed contracts to the CPUC for approval after the winning bidders are
8 selected. As with the Interim Procurement Contracts, the Renewable Energy Contracts will
9 be the legal and financial responsibility of DWR until PG&E regains its investment-grade
10 credit rating.

11 8. The CPUC Decision also requires that the IOUs offer to extend the term of
12 certain QF contracts whose prices are established under federal law and whose costs are
13 fully recoverable in PG&E's rates under that law. Specifically, the CPUC Decision provides
14 that the IOUs are required to offer Standard Offer 1 contract extensions to QFs, meeting the
15 following conditions: (i) the QF must have been in operation and under contract to provide
16 power with an IOU at any point between January 1, 1998 and the effective date of the CPUC
17 Decision; and (ii) the QF contract must be set to expire before January 1, 2004, have already
18 expired or have already been terminated. The CPUC Decision requires PG&E to submit the
19 proposed QF contract extensions ("QF Contract Extensions") to the CPUC for approval.

20 9. PG&E submitted the Interim Procurement Contracts to the CPUC for
21 approval on October 22, 2002 and anticipates submitting the Renewable Energy Contracts to
22 the CPUC for approval by November 5, 2002. A true and correct copy of the October 22,
23 2002 Advice Letter to the CPUC is attached hereto as Exhibit B. Under the CPUC Decision,
24 PG&E anticipates that CPUC approval will be obtained within 30 days of submission.
25 PG&E's obligation to enter into these contracts is conditioned upon: (i) CPUC approval, in a
26 form satisfactory to PG&E in its sole discretion, of the contracts with timely cost recovery
27 and no "reasonableness" review, thereby ensuring that PG&E will be entitled to rate
28 recovery for the cost of the power purchased thereunder for the entire term of the contracts;

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1 and (ii) PG&E having no immediate legal or financial obligation under the contracts because
2 DWR will participate as a contracting party with the full legal and financial responsibility
3 for the contracts until PG&E regains its investment-grade credit rating.

4 10. The general terms and conditions applicable to the Interim Procurement
5 Contracts are set forth in the attached exhibits as follows: (i) 5 Confirmation Letters (Exhibit
6 C), representing terms applicable to each of the products that PG&E was authorized to
7 solicit bids for (system tolling, unit tolling, firm energy, seasonal exchange and weekly
8 exchange products); (ii) Master Power Purchase and Sale Agreement (Exhibit D); (iii)
9 Guaranty Agreement (Exhibit E); and (iv) Surety Bond (Exhibit F).

10 11. PG&E is requesting approval to enter into the Interim Procurement
11 Contracts without the necessity of disclosing certain material terms, including the specific
12 suppliers with whom PG&E will contract, the contract prices and contract quantities, due to
13 the commercially sensitive nature of this information. However, PG&E notes that the terms
14 of the Interim Procurement Contracts range from one to three years commencing on and
15 after January 1, 2003. Furthermore, PG&E estimates that the total costs to be incurred under
16 the Interim Procurement Contracts will not exceed \$42 million in 2003, \$37 million in 2004,
17 and \$33 million in 2005.

18 12. As set forth in more detail in the Advice Letter, PG&E attempted to obtain
19 the largest possible number of bids in the procurement process. In developing its list of
20 potential bidders, PG&E contacted current California market participants, suppliers with
21 whom PG&E has previously contracted, suppliers with DWR contracts and other potential
22 participants. PG&E also worked with industry groups, including Independent Energy
23 Producers, to identify additional potential suppliers. As a result of this process, PG&E
24 received and evaluated 59 bids for the Interim Procurement Contracts. All bids that were
25 timely received were explicitly modeled and a market value was calculated. PG&E
26 reviewed each of the bids to ensure that each transaction met certain basic commercial and
27 non-commercial terms, eliminating those that did not meet the basic terms. PG&E examined
28 the characteristics of the existing portfolio to determine its sensitivity to various risk factors

1 such as electric price, gas price, hydro conditions and variations to load. The proposed
2 transactions were evaluated, including calculations of value under a wide range of scenarios.
3 A short list of proposed suppliers with higher market values and higher cost/benefit ratios
4 was selected and the Interim Procurement Contracts were negotiated with the proposed
5 suppliers.

6 13. The CPUC Decision required that PG&E establish a Procurement Review
7 Group ("PRG") to ensure that the Interim Procurement Contracts would be subject to
8 sufficient review before being submitted to the CPUC. In addition to *ex officio* members,
9 CPUC Energy Division and the Office of Ratepayer Advocates ("ORA"), the PRG included
10 The Utility Reform Network ("TURN"), the California Energy Commission ("CEC"), the
11 Natural Resources Defense Council ("NRDC") and California Utility Employees ("CUE").
12 Subject to non-disclosure agreements, the PRG members had the right to consult with PG&E
13 and review the details of PG&E's interim procurement strategy, proposed procurement
14 contracts and procurement processes. After participating in this process, none of the PRG
15 members oppose CPUC approval of the Interim Procurement Contracts and TURN
16 affirmatively supports CPUC approval. NRDC, CEC and CUE neither support nor oppose
17 CPUC approval of the Interim Procurement Contracts. ORA and CPUC Energy Division are
18 not taking any position at this time.

19 14. The general terms and conditions applicable to the Renewable Energy
20 Contracts are substantially the same as those applicable to the Interim Procurement
21 Contracts, with two material exceptions: (i) the contracts will be for 5, 10 and 15-year terms,
22 commencing on and after January 1, 2003; and (ii) there will be a liquidated damages
23 provision in the amount of \$15,000 for each megawatt ("MW") specified in the contract
24 documents if a unit covered thereby is not operable and deliverable to PG&E by December
25 31, 2003. Suppliers under the Renewable Energy Contracts will be required to post a letter
26 of credit or a surety bond to secure their obligations. The 2 Confirmation Letters applicable
27 to the Renewable Energy Contracts (for unit-firm and intermittent renewable products) are
28 attached hereto as Exhibit G.

1 15. After conducting a competitive bidding process for the Renewable Energy
2 Contracts, PG&E received responses representing approximately ten times the volume
3 needed to satisfy the requirements in the CPUC Decision for 2003. Evaluations of the offers
4 and discussions with potential suppliers are currently ongoing (some of the offers were
5 eliminated based on non-compliance with the terms of the offer). PG&E expects to
6 negotiate final contracts that will meet the 1% requirement discussed above. The CPUC
7 Decision also set a provisional benchmark price of 5.37 cents per kilowatt hour ("KWh"), at
8 or below which any Renewable Energy Contract would be deemed reasonable by the CPUC.
9 PG&E anticipates that the aggregate of the Renewable Energy Contracts should be within
10 the range of this benchmark and should not exceed 6 cents per KWh; based thereon, it is
11 estimated that the total costs for 2003 will not exceed \$45 million.

12 16. PG&E is also requesting approval to enter into the Renewable Energy
13 Contracts without necessity of disclosing certain material terms, including the specific
14 suppliers with whom PG&E will contract, the contract prices and contract quantities, due to
15 the commercially sensitive nature of this information. As with the Interim Procurement
16 Contracts, the Renewable Energy Contracts will be subject to the PRG review process.

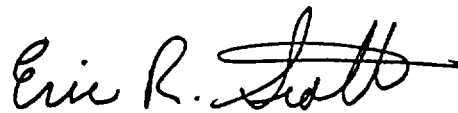
17 17. In the event that the conditions PG&E has placed on its willingness to enter
18 into the contracts are not met (i.e., acceptable commercial terms, DWR agreement to assume
19 full legal and financial liability until PG&E is investment-grade, and CPUC approval of the
20 reasonableness of the contracts for ratemaking purposes), PG&E retains the discretion not to
21 enter into the Interim Procurement Contracts and the Renewable Energy Contracts.

22 18. PG&E has identified twelve (12) QFs that qualify for contract extensions
23 under the terms set forth in the CPUC Decision and have expressed a willingness to enter
24 into the contract extensions. PG&E intends to request CPUC approval for the QF Contract
25 Extensions by November 5, 2002. The QF Contract Extensions will be executed in
26 substantially the form attached hereto as Exhibit H. Generally, the QF Contract Extensions
27 will provide for a term ending no later than December 31, 2003. The CPUC Decision
28 provides for the term of the applicable QF contracts to be extended to the date on which

1 PG&E fully implements its long term procurement plan approved by the CPUC or to
2 December 31, 2003, whichever occurs first.

3 19. PG&E estimates that the total costs for 2003 under the QF Contract
4 Extensions will not exceed \$59.5 million. The pricing under the QF Contract Extensions
5 consists of variable energy and fixed capacity components. The fixed capacity component is
6 currently set at \$62 per kilowatt-year. The variable energy payment will be the Short-Run
7 Avoided Cost, a formulaic price based upon an index of natural gas prices that is
8 recalculated and published monthly. The 12 QFs represent an installed capacity of
9 approximately 212 MW and are estimated to generate approximately 860 GWh in 2003, or
10 approximately 1.1% of PG&E's annual electricity sales.

11 I declare under penalty of perjury under the laws of the United States of America
12 that the foregoing is true and correct and that this Declaration is executed this 25th day of
13 October, 2002, at San Francisco, California.

14 
15 ERIC R. SCOTT

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